IT 07-0002-GIL 02/02/2007 PUBLIC LAW 86-272/NEXUS

General Information Letter: Activities described appear to be protected activities under Public Law 86-272.

February 2, 2007

Dear:

This is in response to your letter dated January 16, 2007 that states the following:

> I am writing to request an exemption certificate from Illinois Business Income Tax for COMPANY, LLC, a STATE limited liability company (the "Company"). On January 1, 2007, the Company added a sales employee who resides in CITY, Illinois. The Company has no other employees who reside in the State of Illinois.
>
> The Company, FEIN XX-XXXXXXX, manufactures industrial furnaces and boilers in STATE and sells its furnaces and boilers wholesale through independent distributors located across the country, including Illinois. The distributors are "independent contractors" within the meaning of Section 100.9720(c)(1)(D) of the Illinois Department of Revenue Regulations (the "Regulations"). The independent distributors activities within the State of Illinois on behalf of the Company consist solely of making sales, or soliciting orders for sales, of the Company's industrial furnaces and boilers to end users.
>
> The new sales employee will work from an "in-home" office as described in Section 100.9720(c)(5)(M) of the Regulations. There will be no telephone listing or other public listing with the State of Illinois for the sales employee in his capacity as such. Other than the normal distribution and use of business cards and stationary identifying the employee's name, address, telephone and fax numbers and affiliation with the Company, there will be no indication through advertising or business literature that the Company or its sales employee can be contacted at a specific address within the State.
>
> The sales employee's activities will be limited to the solicitation of orders from current and potential independent distributors. All such orders will be sent to STATE for approval or rejection, and if approved, will be filled by shipment from the Company's manufacturing site in STATE. The sales employee will not engage in any "unprotected activities" as defined in Section 100.9720(c)(4)(A)-(S) of the Regulations.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill.Adm.Code §1200, or on the website http://www.revenue.state.il.us/legalinformation/regs/part1200.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

The Illinois Department of Revenue does not provide companies with "an exemption certificate from Illinois Business Income Tax." The determination whether a taxpayer has nexus to subject it to Illinois Income Tax is extremely fact-specific. Therefore, the Department does not issue rulings regarding whether a particular taxpayer has nexus with the State. However, general information regarding nexus with Illinois for income tax purposes may be provided.

Section 201 of the Illinois Income Tax Act ("IITA"), 35 ILCS 5/101 et seq, imposes a tax measured by net income on taxpayers for the privilege of earning or receiving income in this State. The Due Process and Commerce Clauses of the Federal Constitution limit the power of Illinois to subject foreign taxpayers to Illinois tax. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction it seeks to tax (Quill Corp. v. North Dakota, 504 U.S. 298, 112 S.Ct. 1904 (1992)). Similarly, the Commerce Clause requires that the tax be applied to an activity with a substantial nexus with the taxing state. Id. Where any part of a foreign corporation's income is allocable to Illinois in accordance with the provisions of Article 3 of the IITA, Illinois can demonstrate the connection, or nexus, necessary to subject a foreign corporation to tax. Therefore, unless protected by Public Law 86-272, a foreign corporation is liable for Illinois income tax where any portion of its income is allocated to Illinois.

IITA Section 304 provides for taxable years ending on or after December 31, 2000 that the apportionment factor for a foreign corporation deriving business income from Illinois and one or more other states shall be equal to its sales factor. Section 304(a)(3)(A) defines the sales factor as a fraction, the numerator of which is the total sales of the person in Illinois during the taxableyear, and the denominator of which is the total sales of the person everywhere. Department of Revenue Regulations100.3700(c)(1) states that gross receipts from sales of tangible personal property are allocable to Illinois for sales factor purposes if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale.

Your letter indicates that your Company intends to sell industrial furnaces and boilers to purchasers in Illinois. Because the sales of furnaces and boilers constitute sales of tangible personal property, a portion of Company's net income may be allocable to Illinois in accordance with the provisions of Article 3 of the IITA. Accordingly, unless protected by Public Law 86-272, Company may be liable for Illinois income tax. Public Law 86-272 is a federal statute that prohibits a state's taxation of interstate sales of tangible personal property. Public Law 86-272 states in part:

> No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either or both of the following:
> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

Illinois construes the protection of Public Law 86-272 very narrowly. Almost any activity exceeding the parameters of that statute will cause that protection to be forfeited. An out-of-state corporation can lose the immunity provided by Public Law 86-272 where its activities within the state exceed the mere solicitation standard of that law. A corporation's activities in Illinois beyond solicitation that are more than *de minimus* will establish nexus with Illinois. De minimus activities are defined in Section

100.9720(c)(2)(D).

Your letter indicates that your Illinois sales employee will maintain an “in-home” office as described in Section 100.9720(c)(5)(M) and that the Illinois sales employee will not engage in any unprotected activities as defined in Section 100.970(c)(4)(A) through (S). Based on the facts as you have provided them in your letter, the Illinois sales employee at issue in your letter would be protected by Public Law 86-272 from Illinois income tax. You also mention independent distributors that sell your furnaces and boilers. Your facts indicate that these distributors are “independent contractors” within the meaning of Section 100.970(c)(1)(D), meaning that are distributors for other furnace and boiler companies, not just yours. Based on the facts as you have provided them in your letter, the Illinois independent distributors would also be protected by Public Law 86-272 from Illinois income tax.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Staff Attorney -- Income Tax